

The social implications of the bond market turmoil

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The headline financial news this week, announced on Wednesday afternoon, was the US Federal Reserve decision to maintain interest rates on hold for the second meeting in a row. But a more significant decision came that morning with the move by the US Treasury to slow the pace and change the composition of its issuance of new debt to be raised on financial markets.

The US Treasury decision did not make it as a top news story, but it was closely followed in financial circles because it related to the all-important question of liquidity—that is, the ability of financial markets to continue financing the ever-growing US government debt without disturbance and ructions.

It is more than three years on, but the experience of March 2020, at the start of the COVID-19 pandemic, when the Treasury market froze for several days because there were no buyers for US government debt, is still fresh in memories in leading financial circles. The US Federal Reserve halted the crisis with a massive intervention by buying up bonds and other financial assets to the tune of around \$4 trillion.

The immediate crisis was resolved but the underlying issue was not. Since then, liquidity in the \$25 trillion US Treasury market has been an ongoing issue.

To understand it, an analogy may be useful. If a rock is dropped in a deep pool of water, then its entry creates little disturbance—a few ripples across the surface. But if the pool is shallow then the entry of the rock causes a major splash and waves.

If the Treasury market is liquid then the issuing of new debt, even in large amounts, has little effect. That was the situation in the “normal” times of the past. Those times have gone. The market is now illiquid and so an increase in issuance has a major effect.

That was seen in August when the US Treasury

announced a large-scale issuance of debt, especially at the long end of the market—10-year and 30-year bonds—to finance the burgeoning US budget deficit.

Writing in the *Sydney Morning Herald* yesterday, economics commentator Stephen Bartholomeusz described what happened.

“Investors were spooked by the sheer scale of the supply of bonds, particularly longer-dated bonds, scheduled to hit the market when the price-sensitive private sector investors are the primary source of demand, given that the Fed is allowing the securities it acquired with its quantitative easing program in response to the pandemic to mature without reinvestment and other central banks are largely absent as buyers.”

That August decision set off a wave of bond selling which sent the yield on the 10-year bonds from around 4 percent to as high as 5 percent at some points. (Yields and bond prices have an inverse relation.) Such a movement, where shifts in yields are normally a fraction of a percentage point, was extraordinary.

Bartholomeusz noted: “It was a bond market rout—one that inflicted losses of multi-billions, perhaps trillions, of dollars for investors in the \$25 trillion market.” It was triggered by the “amount of long-term debt the market was being asked to absorb as a result of the \$1.7 trillion US budget deficit.”

Fearing a repeat, on Wednesday the US Treasury modified the profile of its debt issuance for the last quarter, saying it would slow the pace of 10-year and 30-year bond issues. In August, it said it would raise the auction size of 10-year bonds by \$3 billion a month and that of 30-year bonds by \$2 billion a month. In the latest decision, the increases were cut to \$2 billion and \$1 billion respectively, while increasing issuance of two- and five-year bonds.

Overall, the Treasury said in the quarterly refunding auctions next week it would sell \$112 billion worth of debt, down from \$114 billion in the previous quarter.

The Treasury move, as well as the Fed decision not to lift interest rates, has calmed the bond market, at least temporarily. There was something of a rally on Thursday, with the yield on the 10-year Treasury moving down by 0.3 percentage points in two days.

But such a shift, large by historical standards, is itself a cause for concern because it is an expression of the volatility in the most important financial market for the US and the global financial system.

Moreover, there is a negative feedback loop at work. Interest rates are being driven up because of increased government spending, especially on the military, while the government must make higher interest payments on its debt.

The US federal deficit increased by \$320 billion to \$1.7 trillion in the year to September. Half of this rise was due to rising interest costs. They will increase further in the future.

The worsening situation in government finances extends around the world and is going to lead to deep attacks on the working class.

Writing in the *Financial Times* last weekend, the deputy managing director of the International Monetary Fund (IMF), Gita Gopinath, said there had been a focus on monetary policy after the pandemic but the recent turbulence in the bond markets meant the winds were shifting and calling for a “renewed focus on fiscal policy.”

She noted the increase in government spending over current outlays, not least because of rising military outlays, could surpass 7 percent of gross domestic product (\$6 trillion) in advanced economies and more than 8 percent of GDP (\$5.3 trillion) in emerging market and developing economies by 2030. Gopinath added that “by any scale, these numbers are enormous.”

Gopinath said that with record high debt levels, higher for longer interest rates and the weakest growth prospects in two decades, “restraint” was required, even for reserve currency issuers, above all the US.

The US has some of the biggest deficits in relation to GDP, expected to be 8 percent this year. Interest payments as a percentage of revenue are set to rise from 8 percent of revenues (\$486 billion) in 2019 to 12

percent by 2028 (\$1.27 trillion).

As one of the voices of finance capital, the IMF has made clear where the response to the crisis must be directed. “For several advanced economies with ageing populations, entitlement reforms are inescapable,” Gopinath insisted.

It will not just be Social Security in the US. Social services across the board, such as health, education and other facilities for life in modern society, are in the firing line. That is, the working class must be made to pay for the deepening crisis of the financial system, exacerbated by the eruption of militarism.



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